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Cases, Regulations, and Statutes

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per animal consuming unit. The animals must have been owned for 90 days or more before and/or after June 1, 2002.

Reports have surfaced that LCP payments are not subject to income tax. Unfortunately, there is no specific statutory exclusion for disaster payments. Apparently, the belief that LCP payments are not taxable is based upon a belief that LCP payments constitute welfare. While various types of disaster payments made to individuals have been excluded from gross income under a general welfare exception, *see, e.g., Rev. Rul. 98-19, 1998-1 C.B. 840*, that exception only applies if the payments are made under legislatively provided social benefit programs for the promotion of the general welfare. Indeed, in *Rev. Rul. 76-144, 1976-1 C.B. 17* and *Rev. Rul. 75-246, 1975-1 C.B. 24* the IRS addressed the general exception from income for welfare benefits received by individuals from governmental units under legislatively provided social benefit programs. However, in the rulings, IRS noted that payments under governmental programs that represent compensation for lost wages or lost profits are includible in gross income. For instance, under I.R.C. § 85, the exception from income for welfare benefits is made inapplicable to unemployment compensation. In addition, the legislative history of I.R.C. § 139(b)(4) states that the exclusion does not apply to payments that are in the nature of income replacement. I.R.C. § 139(b)(4) codifies the general welfare exception for payments to individuals in connection with a qualified disaster.

Consequently, there is little doubt that LCP payments constitute income replacement and are, therefore, subject to income taxation in the hands of the recipient.

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CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

ESTATE PROPERTY. The debtor owned an interest in an ERISA qualified I.R.C. § 401(k) pension plan. Although the IRS agreed that the plan was not part of the bankruptcy estate, the IRS argued that the plan was subject to a tax lien such that the tax lien was a secured claim. The court held that the plan was not estate property for any bankruptcy purpose, including securing a tax lien. ***In re* Wingfield, 284 B.R. 787 (E.D. Va. 2002)**.

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. The debtor failed to file income tax returns for two tax years and the IRS made assessments based upon substitute returns created by the IRS. The taxpayer then filed income tax returns which used the amounts assessed by the IRS as the taxes owed. The IRS entered into an installment payment agreement with the taxpayer but the taxpayer failed to complete the payments and filed for bankruptcy. The court held that the taxes were nondischargeable because the taxpayer's late returns did not qualify as returns for purposes of Section 523(a)(1) since they did not add to the information already included on the substitute returns. ***In re* Weintraub, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,195 (Bankr. M.D. Fla. 2003)**.

The taxpayer failed to file income tax returns for 1988 through 1997. The IRS made assessments based on substitute returns it constructed. One year later the taxpayer filed income tax returns for the missing years, and the IRS treated the returns as amended returns and reduced the assessment. The court held that the returns filed by the taxpayer were considered returns under Section 523(a)(1) because the returns were accepted as amended returns and affected the amount of tax assessed. ***In re* Izzo, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,190 (Bankr. E.D. Mich. 2002)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The plaintiffs were a group of farmers who purchased or attempted to purchase a crop revenue coverage (CRC) insurance policy for their durum wheat during the 2001 crop year. The FCIC determined that a base price for durum wheat could not be established without an illegal amendment to the policy and terminated the policy. The policy provided for determination of the base price on the September futures contract, if it included at least 15 days of daily settlement prices. If the September futures contracts do not contain at least 15 trading days, then the July futures are used, again requiring at least 15 trading days. The trading days actually occurred in the previous February and November. In this case, the September and July futures together did not have a total of 15 trading days. The FCIC argued that this prevented any policy from being issued. The plaintiffs argued that the FCIC could have used as many of the March futures trading days as needed to make 15 trading days. The court held that the FCIC interpretation of the policy was correct and restricted the trading days to September and July only. Because the CRC policy itself could not be changed, termination was the proper remedy. **Kuster v. Veneman, 226 F. Supp.2d 1190 (D. N.D. 2002)**.

EXOTIC NEWCASTLE DISEASE. The APHIS has issued interim regulations amending the exotic Newcastle disease regulations by quarantining Clark County and a portion of Nye County in Nevada and prohibiting or restricting the movement of birds, poultry, products, and materials that could spread exotic Newcastle disease from the quarantined area. **68 Fed. Reg. 3375 (Jan. 24, 2003)**.

**Agricultural Law Manual* (ALM).

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATIVE EXPENSES. The decedent's estate claimed deductions for interest on overpayment of estate tax, attorney's fees, executor's fees, and miscellaneous expenses. The IRS argued that the interest was not deductible because the interest would eventually be returned as a refund. The court originally held that all the interest was deductible because it was already paid and any refunded portion would be included in income when refunded. The other expenses were approved by the probate court but the IRS challenged the expenses for lack of substantiation. The court held that the acceptance of the validity of the expenses by the state court was sufficient evidence to support the deductions. On reconsideration, the court held that an interest deduction was allowed only for the portion of the interest paid which was not refundable. **Helis v. United States, 2002-2 U.S. Tax Cas. (CCH) ¶ 60,445 (Fed. Cls. 2002), *on reconsideration*, 2003-1 U.S. Tax Cas. (CCH) ¶ 60,454 (Fed. Cls. 2003)**.

DISCLAIMER. The decedent's children, grandchildren and surviving spouse disclaimed fractional interests in various bequests from the decedent. The IRS ruled that the disclaimers were effective. **Ltr. Rul. 200303020, Sept. 30, 2002**.

TRANSFERS WITH RETAINED POWERS. The decedent had transferred assets to a family limited partnership in exchange for a limited partnership interest. The partnership agreement gave the decedent the power to designate a new general partner who did not owe a fiduciary duty to any partner. The court held that the assets were included in the decedent's estate because the power to control the general partner was a power to control who received the benefits of the assets. The court also held that the transfer was not a bona fide sale because there were no arm's-length negotiations and the decedent received no consideration for the transfer other than a "recycling" of the assets into a partnership interest. **Kimbell v. United States, 2003-1 U.S. Tax Cas. (CCH) ¶ 60,455 (N.D. Tex. 2003)**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The IRS has announced plans to issue amendments to the regulations governing use of the nonaccrual experience (NAE) method of accounting. The IRS has provided advance notice of the probable amendments which include: (1) procedures to change the method of accounting for taxpayers who no longer qualify to use a NAE method,; (2) two safe harbor NAE methods that will be presumed to clearly reflect the taxpayer's NAE; (3) for taxpayers who qualify to use a NAE method but wish to compute their NAE using a formula other than the two safe harbors provided, the requirements that must be met in order to use an alternative formula to compute their NAE; and (4) for taxpayers who wish to change to a different NAE method, the procedures necessary to obtain automatic consent of the IRS to change to one of the safe harbor NAE methods or to an alternative NAE method that clearly reflects their experience. **Notice 2003-12, I.R.B. 2003-__**.

In the early 1990s, the taxpayer built and placed into service several gas station convenience stores and initially claimed depreciation deductions under the MACRS for the properties as nonresidential 31.5 or 39 year recovery property. In 1996 the taxpayer filed amended returns which reclassified the property as 15-year property, consistent with an Industry Specialization Program Coordinated Paper issued by the IRS. In 1996 and 1997 the taxpayer's tax returns continued to claim depreciation deductions using the 15-year classification. The IRS argued that the change of depreciation method was a change in accounting method which required IRS approval. There was no disagreement that the properties were not properly 15-year recovery property. The court held that the change in the depreciation calculation was not a change in accounting method which required IRS consent. **Brookshire Brothers Holding, Inc. v. Comm'r, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,214 (5th Cir. 2003), *aff'g*, T.C. Memo. 2001-150**.

CORPORATIONS

MERGER. The taxpayer was an automobile dealership corporation which acquired another corporation which also operated a dealership, but with a different brand of automobile. The taxpayer merged the two corporations into a new corporation which operated the two automobile dealerships. The IRS ruled that the merger was an expansion of an existing business for purposes of I.R.C. § 355(a). **Rev. Rul. 2003-18, I.R.B. 2003-__**.

COST-SHARING PAYMENTS. The IRS has ruled that cost-sharing payments received under the Agricultural Management Assistance Program are excluded from income under I.R.C. § 126. **Rev. Rul. 2003-15, I.R.B. 2003-4**.

The IRS has ruled that cost-sharing payments received under the Water Conservation Assistance Program are excluded from income under I.R.C. § 126. **Rev. Rul. 2003-14, I.R.B. 2003-4**.

COURT AWARDS AND SETTLEMENTS. The taxpayer had filed suit against an employer for wrongful termination. The taxpayer signed a contingency fee agreement with the taxpayer's lawyers, who received one-third of the initial judgment and an hourly rate for the appeal. The taxpayer excluded the amount paid to the lawyers under the contingency fee agreement. The court acknowledged a split in authority on this issue and a lack of authority from the Second Circuit Court of Appeals. The court held that the contingency fee payment was not included in the taxpayer's income because the fee was never a personal obligation of the taxpayer nor was that portion of the judgment ever in the control of the taxpayer. The court focused on the taxpayer's rights to the money at the time the contingency fee agreement was executed and noted that the taxpayer had no right to the money at that time. **Raymond v. United States, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,196 (D. Vt. 2002)**.

DISABILITY PAYMENTS. The taxpayer was retired and received disability annuity payments from a former employer. The taxpayer did not include the payments in income. The court held that the payments were included in income because the taxpayer failed to show that the amounts were attributable to contributions made by the taxpayer. **Laws v. Comm'r, T.C. Memo. 2003-21**.

EARNED INCOME CREDIT. The IRS has reminded taxpayers that changes in the earned income tax credit law will expand the number of low-income working taxpayers, especially military personnel, who qualify for tax relief for 2002. To be eligible for a full or partial credit, a taxpayer must have an adjusted gross income of less than: (1) $33,178 ($34,178 married filing jointly) and two or more qualifying children; (2) $29,202 ($30,202 MFJ) and one qualifying child; or (3) $11,060 ($12,060 MFJ) with no children. The maximum earned income credit is $4,140 for families with two or more qualifying children, $2,506 for families with one qualifying child and $376 for an individual without children. Other significant changes include: (1) income calculations will be based on adjusted gross income, not modified adjusted gross income; (2) eligible foster children must live with a guardian more than half a year, reduced from a one-year rule; (3) for taxpayers who are "married filing jointly," the maximum adjusted gross income limit is $1,000 more than other filing statuses; and (4) EITC is no longer reduced by the amount of any alternative minimum tax. **IR-2003-12**.

PARTITION OF PROPERTY. The taxpayers were two parents, one of their children and a trust for another child. The four taxpayers owned a property as joint tenants, tenants in common or undivided fee interest in a portion of the property or a life estate in the property. The taxpayers split the property into parcels equal in value to their previous partial interests, with each taxpayer owning the entire fee interest in one portion of the property. The IRS ruled that the partition of the property was not a sale or exchange and did not result in recognition of gain. **Ltr. Rul. 200303023, Oct. 1, 2002**.

RETURNS. The IRS has announced that taxpayers who live in Arizona, Idaho, Indiana, Kentucky, Louisiana, Maine, Mississippi, Nebraska, New Jersey, New Hampshire, North Dakota, Ohio, Oklahoma, South Dakota, Vermont or Washington, who did not receive an instruction booklet in the mail, and who are mailing a paper tax return, will file their tax returns with different Internal Revenue Service Centers during 2003 than they did during 2002. Taxpayers who received a tax instruction booklet from the IRS in the mail and use the labels included with the booklet can be assured that their tax returns will go to the correct address. During 2003, for taxpayers in Mississippi, the address is Internal Revenue Service Center, Atlanta, GA 39901; for taxpayers in Maine, New Hampshire and Vermont, the address is Internal Revenue Service Center, Andover, MA 05501; for taxpayers in Indiana, Nebraska, North Dakota and South Dakota, the address is Internal Revenue Service Center, Kansas City, MO 64999; for taxpayers in New Jersey, the address is Internal Revenue Service Center, Philadelphia, PA 19255; for taxpayers in Kentucky, Louisiana and Oklahoma, the address is Internal Revenue Service Center, Austin, TX 73301; for taxpayers in Arizona, Idaho and Washington, the address is Internal Revenue Service Center, Fresno, CA 93888; and for taxpayers in Ohio, the address is Internal Revenue Service Center, Memphis TN 37501. Taxpayers enclosing a check should add "-0102" to the zip code listed above if sending a Form 1040, "-0115" for Form 1040A, or "-0114" for Form 1040EZ. Those not enclosing a check should add "-0002" if sending a Form 1040, "-0015" for Form 1040A, or "-0014" for Form 1040EZ. **IR-2003-10**.

S CORPORATIONS

TRUST. The taxpayer was an S corporation with an electing small business trust as a shareholder. The trust transferred the stock to an LLC which was not taxed as an association in exchange for 100 percent interest in the LLC. The IRS ruled that the transfer did not disqualify the trust for ESBT treatment nor effect the taxpayer's S corporation status. **Ltr. Rul. 200303032, Oct. 8, 2002**.

SAFE HARBOR INTEREST RATES

February 2003

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	1.65	1.64	1.64	1.63
110 percent AFR	1.81	1.80	1.80	1.79
120 percent AFR	1.98	1.97	1.97	1.96
Mid-term				
AFR	3.27	3.24	3.23	3.22
110 percent AFR	3.59	3.56	3.54	3.53
120 percent AFR	3.93	3.89	3.87	3.86
Long-term				
AFR	4.85	4.79	4.76	4.74
110 percent AFR	5.34	5.27	5.24	5.21
120 percent AFR	5.83	5.75	5.71	5.68

Rev. Rul. 2003-16, I.R.B. 2003-__.

SALE OF RESIDENCE. Under the final regulations issued for the exclusion from income of gain on the principal residence, see I.R.C. Sec. 121, homeowners are not required to allocate any part of the gain to the business portion of their home on sale, so long as the office was within the dwelling unit. This can be of great significance on sale of the residence. Remember, to qualify for the home office deduction, the area must be used regularly and on an exclusive basis for business purposes as the principal place of business for any trade or business of the taxpayer. However, a taxpayer must still pay tax on the gain equal to the depreciation allowed or allowable after May 6, 1997. See I.R.C. Sec. 121(d)(6). **67 Fed. Reg. 78,358, December 24, 2002, adding Treas. Reg. 1.121-1(e)(1).**

TAX SHELTERS. The taxpayer invested in a farm tax shelter partnership which was determined to be a sham by the IRS. The taxpayer was assessed for taxes and assessed enhanced interest under I.R.C. § 6621(c) because the partnership was determined to be a sham. The court held that imposition of enhanced interest required a showing that the partnership lacked economic substance and the taxpayer lacked any profit motive in making the investment. Because the court held that the taxpayer had a profit intent when the investment was made, the court held that the assessment of enhanced interest was improper. **Weiner v. United States, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,191 (S.D. Tex. 2002)**.

TRUSTS. The taxpayers, husband and wife, transferred their sole proprietorship business, residence and bank accounts to several business trusts. Although the trusts filed tax returns, the taxpayers did not report any self-employment income or income received from the trusts. The court held that the trusts were shams and upheld the IRS assessment of taxes and accuracy-related penalties. **Nichols v. Comm'r, T.C. Memo. 2003-24**.

STATE REGULATION OF AGRICULTURE

GRAPE CHECKOFF. The California legislature established the California Table Grape Commission by statute for the promotion of California fresh table grapes. The Commission had the authority to and did levy assessments to fund generic advertising, marketing, market research and merchandising of table grapes. The plaintiffs were sellers of brand name table grapes and were assessed the marketing fees on their grapes. The plaintiff brought suit, arguing that the assessments violated their First Amendment rights. The court held that the grape fee and promotional program in California was similar to the mushroom program in United States v. United Foods, Inc., 533 U.S. 405 (2001) in that the grape and mushroom fee and promotion programs were not part of a broader collective enterprise that displaced many aspects of the business activity of the industry. **Delano Farms Co. v. California Table Grape Commission, No. 00-16778 (E.D. Calif. 2003)**.

STATE TAXATION

AGRICULTURAL USE. The plaintiff operated two greenhouses on two neighboring parcels of land. The operation consisted of indoor and outdoor growing areas and a retail outlet, although most of the plants were sold at wholesale. The indoor growing facilities used soil from other sources. The property was originally taxed as commercial property but the plaintiff obtained a ruling from the Board of Assessment Appeals that the land was taxable as agricultural land. Under Colo. Const. art. X, § 3(1)(a) and Colo. Rev. Stat. § 39-1-103(5)(a), agricultural land is defined as property used for two years as a farm or ranch. Colo. Rev. Stat. § 39-1-102(1.1) defines agriculture as including horticulture. The BAA had ruled that, because the greenhouses produced horticultural products, the properties were farms. The court noted; however, that Colo. Rev. Stat. § 39-1-102(3.5) requires that the agricultural products originate from the land's productivity. Therefore, the court held that the property was not a farm and was not entitled to be taxed as agricultural property. **Welby Gardens Co. v. Colorado Board of Assessment Appeals, 56 P.3d 1121 (Colo. Ct. App. 2002)**.

The plaintiffs owned rural land which was classified as agricultural for real property tax purposes. The property was used by the plaintiffs as a crop and livestock farm. In 1999 the county assessor changed the classification from agricultural to residential based on the increased market value for rural properties for residences. The plaintiffs challenged the reclassification, and while their appeal was pending before the Iowa Supreme Court, they received their 2000 assessment, again based upon a residential classification and including an increase in valuation. The plaintiffs appealed the 2000 classification and obtained a favorable ruling from a state District Court. The plaintiffs then dismissed their 1999 classification appeal. The assessor argued that the doctrine of res judicata, specifically issue preclusion, prevented the plaintiffs from challenging the 2000 classification. The court held that the classification each tax year was a separate cause of action; therefore, the 1999 classification and appeal did not adjudicate the classification for 2000. However, the court held that the primary issue was whether the use of the land changed from 1999 to 2000 because a classification is presumed to be correct absent any change in use. Since the plaintiffs admitted that the use of the property had not changed, the 1999 residential classification was presumed to continue to 2000; therefore, the District Court's ruling that the land was agricultural was improper. Thus, in Iowa, once a property tax classification has reached final adjudication, it has the effect of res judicata for subsequent tax years absent evidence of change of use. *Query*: The court stated that the property had been used for crops and livestock production since 1983 and did not point to any evidence from the assessor to support the residential classification except the tendency of people to want to live in the country; so how can the plaintiffs change their use to farming if they are already farming? This paradox was created by this case because the court allowed the classification as proof of use; whereas, the assessor's reclassification was not based on any change of use but primarily on a change in the market for rural property. The agricultural use valuation laws are designed to help farmers keep their land in agriculture, even though there is more value in selling it for residential use. Here the plaintiffs are now encouraged to remove their land from farming and sell to residential developers. **Colvin v. Story County Board of Review, 653 N.W.2d 345 (Iowa 2002)**.

PERSONAL PROPERTY. The plaintiffs were several companies which owned personal property used in agricultural, trade or businesses. Under Ariz. Rev. Stat. § 42-11127 (1999), "assessment accounts" were each allowed a $50,000 exemption from tax for personal property used in agricultural, trade or businesses at each business location. The court held that the statute violated the Arizona Constitution, Ariz. Const. art. 9, § 2(6), which has been held to limit the $50,000 exemption to all personal property owned by a single taxpayer at all locations. **Maricopa County v. Kinko's, Inc., 56 P.3d 70 (Ariz. Ct. App. 2002)**.

CITATION UPDATES

Estate of Atkinson v. Comm'r, 309 F.3d 1263 (11th Cir. 2002), *aff'g*, 115 T.C. 26 (2000) (charitable deduction) see Vol. 13 p. 180 *supra*.

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